

**STATE BOARD OF ACCOUNTS**  
**302 West Washington Street**  
**Room E418**  
**INDIANAPOLIS, INDIANA 46204-2765**

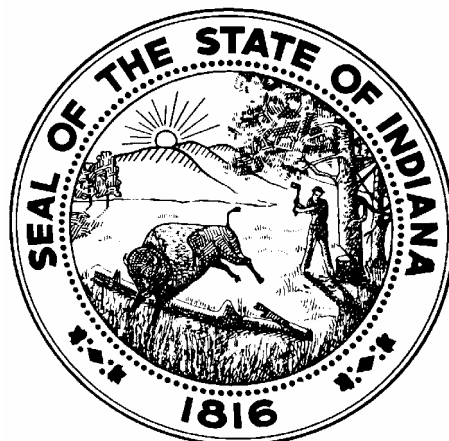
AUDIT REPORT

OF

PUBLIC EMPLOYEES' RETIREMENT FUND  
BOARD OF TRUSTEES

STATE OF INDIANA

July 1, 2002 to June 30, 2003





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#### AGENCY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Executive Director	Mr. E. William Butler	07-01-02 to 09-28-02
Acting Executive Director	Mr. Fred R. Biesecker Mr. Bruce Kimery	10-03-02 to 01-31-03 02-01-03 to 02-09-03
Executive Director	Mr. Craig Hartzer	02-10-03 to 06-30-04
Chairman of the Board	Mr. Jonathan Birge	11-09-01 to 11-08-04



# STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

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TO: THE OFFICIALS OF THE PUBLIC EMPLOYEES' RETIREMENT FUND

We have audited the financial statements of the Public Employees' Retirement Fund of Indiana as of and for the year ended June 30, 2003, and have issued our opinion thereon dated January 7, 2004. The financial transactions of this office are reflected in the Public Employees' Retirement Fund of Indiana's Comprehensive Annual Financial Report.

In planning and performing our audit, we considered the internal controls over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain conditions in the design or operation of one or more of the internal control components that, in our judgment, could adversely affect the Board's ability to record, process, summarize, and report financial information or does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We also noted certain issues of non-compliance with statutes, Board policies, or contracts that in our opinion should be communicated to management.

The internal control conditions and the issues of non-compliance are disclosed in the following audit results and comments.

STATE BOARD OF ACCOUNTS

April 12, 2004

PUBLIC EMPLOYEES' RETIREMENT FUND OF INDIANA  
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INTERNAL CONTROL STRUCTURE AND ENVIRONMENT

In our prior five audit reports we disclosed that certain components of the Public Employees' Retirement Fund of Indiana's (PERF) internal control structure had not been designed or implemented in order to ensure that control procedures, information and monitoring occurred. The components identified included: reserve reconcilements; financial accounting and reporting; investment accounting and transfers; and checking account reconcilements. These areas were again found to have control weaknesses and findings that are detailed further in this report. Additionally, during fiscal 2003, we found an inadequate overall internal control design and level of control consciousness. The additional findings relate both to the previously reported areas, as well as to the computer system that was implemented for retirement transactions in May 2002. The following deficiencies in internal control design were noted:

- (1) Absence of appropriate segregation of duties consistent with appropriate control objectives.
- (2) Absence of appropriate reviews and approvals of transactions, accounting entries, or system output.
- (3) Evidence that a system fails to provide complete and accurate output that is consistent with objectives and current needs.

Failures in the operation of internal control were also found to have occurred as evidenced by the willful wrongdoing of two temporary employees, in separate incidents. Prosecutors filed criminal charges against these two, as well as accomplices. Special investigations remain ongoing.

Indiana Code 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's; (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

CHECKING ACCOUNTS – Cash Necessary to Balance

PERF maintains two checking accounts for benefits and refunds issued. We determined that both accounts have not been reconciled. As of June 30, 2003, we calculated cash necessary to balance of \$5,935,733 for the checking account maintained for the PERF, Judges', Prosecutors', Conservation and Excise Police Officers' and Legislators' Funds. A separate checking account is maintained for the 1977 Police Officers and Firefighters' Pension and Disability Fund and the Pension Relief fund. This account had cash necessary to balance of \$55,052 at June 30, 2003.

Of the \$5,935,733 cash necessary to balance in the PERF checking account, \$2,278,211 was identified as caused by the overpayment of withholding taxes.

We stated in the two prior audit reports that our review of the PERF benefit checking account reconciliation showed unexplained differences, and that reconciliations were not completed since December 2001. With the switch to the new retirement system (SIRIS) the outstanding checklist was either unavailable or inaccurate. We have stated in the past three audit reports that there were unexplained differences for the 1977 fund checking account.

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Each agency is responsible for maintaining an effective and accurate accounting system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank or Auditor's balance should agree. If reconciled bank or Auditor's balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance.

RESERVE RECONCILEMENTS

For each fund administered as of June 30, 2003, the member and employer reserves had unidentified variances between the subsidiary computer system records and the general ledger balances that were either significant or material to the fund.

In our prior five audit reports, we stated that the subsidiary ledgers for employee and employer accounts were not reconciled to the reserve balances maintained on the general ledgers. We recommended that PERF reconcile on a timely basis the subsidiary ledgers for employee and employer accounts to the reserve balances maintained on the general ledgers. From July 2000 to March 2002, no reconciliations were performed. During this time, a critical system conversion occurred. Prior to that time, and thereafter, incomplete reconcilements were performed with resulting unidentified variances.

Factors that cause continued incomplete reconcilements include the following:

- (1) Lack of research to identify variances that continue from prior periods.
- (2) Monitoring and research as to system entries is impeded by the lack of audit trails of system transactions to support or identify the composition of grand totals reported.
- (3) The system accounting entries have not been defined. A listing of automatic computer generated entries was not provided or available. Certain entries could not be explained by either PERF or computer design consultants.
- (4) Known system failures in reporting accurate totals were identified due to the material totals involved. Smaller system variances could occur on an ongoing basis and remain undetected.
- (5) Lack of procedures to identify the total contributions received that have not been posted to SIRIS.
- (6) Monthly reconcilements were performed by the same accountant responsible for general ledger entries.
- (7) Incomplete accounting for manual checks issued.

The lack of timely reconcilements may allow errors on the general ledgers or system programming problems on SIRIS to go undetected. This could result in undetected fraud, incorrect transfers for members' investment options, or misstated reserve balances.

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Indiana Code 5-10.2-2-2 directs that the Board of Trustees of the Public Employees' Retirement Fund shall establish separate accounts designated the retirement allowance account and the annuity savings account. IC 5-10.2-2-6 further requires separate accounts for employer contributions from the state and each political subdivision be maintained within the retirement allowance account.

Indiana Code 5-10.3-3-7.1 provides that: "The board shall annually analyze for internal control purposes the fund's;

- (1) income and expenditures;
- (2) actuarial condition;
- (3) reserve accounts;
- (4) investments; and
- (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

INVESTMENT ACCOUNTING AND TRANSFERS

During the fiscal year ended June 30, 2003, PERF did not have procedures in place to ensure that: investment transfers were executed as ordered; investment deposits were accurately recorded; withdrawals agreed to authorized orders and were recorded to the correct owner account. In February 2003, the custodian bank began preparing summary spreadsheets that reflected comparisons between some transactions of the underlying investment accounts of the commingled retirement investment fund (CRIF) and each owner fund bank account. PERF did not detect, however, that a \$3 million investment, transferred in to the commingled account in February 2003, was not recorded as owned by the PERF fund.

The practice in place at the investment department was to place orders for account transfers without subsequently verifying the detail transaction. From July to October 2002, the investment department directed transfers of investments between accounts, exchanged stocks held for mutual fund shares, and directed sales of investments to identified buyer funds. These totaled in excess of \$2 billion and yet had not been verified as accurately executed. Upon our review PERF obtained reports and information from the mutual fund company. Variances were found that were caused by: the custodian bank recorded the investment transferred out of accounts at cost value only; the mutual fund company held the PERF assets it received for up to two weeks prior to issuing the mutual fund shares, during which time it executed trades as needed, and incurred market fluctuations.

PERF must also ensure the accuracy of accounts solely owned by funds, or that have shared ownership with the CRIF and annuity savings accounts. The investment transfers for annuity savings account directions for the quarter ended March 31, 2003, were not made. This was not detected until after fiscal year end with correction orders placed in August 2003. The bank accounts for the Public Safety Officers' Death Benefit fund and the State Employees' Death Benefit Funds had their names reversed upon establishing accounts with a new custodian bank. This was not corrected and associated errors were not detected by PERF.



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In four prior audit reports for the fiscal years ended June 30, 1998, thru 2001, we recommended that management establish procedures that include having employees other than those who conduct the transactions review the investment transaction. Certain procedures were implemented in fiscal 2002, but were discontinued. We again recommend that procedures be established in order to ensure that: contributions are deposited in the appropriate investment accounts and are recorded in the correct fund's unitized owner account; transfers are between authorized accounts; transactions are in compliance with Board decisions and directives; and that a timely review of custodian bank reports has occurred. Evidence of such controls and results should also be established and communicated to management on a regular basis, and made available for audit.

Indiana Code 5-10.3-3-7.1 states: "The board shall annually analyze for internal control purposes the fund's; (1) income and expenditures; (2) actuarial condition; (3) reserve accounts; (4) investments; and (5) such other data as necessary to interpret the fund's condition and the board's administration of the fund."

#### MUTUAL FUND INVESTMENTS

Board minutes from meetings of the PERF Board of Trustees did not indicate that the Board had approved or authorized the transfer of investments in exchange for mutual fund shares. There were four such transfers that totaled over two billion dollars and occurred from July thru October 2002. There also was no indication of approval of the reversal of two of the transfers, whereby in June 2003, stocks were transferred to PERF in exchange for the return of the mutual funds.

The Board of Trustees formally determines fund investments in accordance with IC 5-10.3-5-3(a).

The Board provides in the approved investment policy guidelines that "Staff duties are to administer the Fund in line with the policies and decisions of the Board and the provisions of governmental law and to provide input for the Board so that issues can be studied fully prior to any Board decision."

Board discussions and decisions should be evidenced in the minutes as required by IC 5-14-1.5-4.

#### FINANCIAL ACCOUNTING AND REPORTING

In our prior five audit reports we recommended that PERF establish reconciling and financial reporting schedules to help ensure procedures are performed in a timely manner so management and staff could detect any errors or differences timely. While some reconciling and financial reporting schedules have been developed, we additionally found a lack of supervisory review and approval of financial accounting records and reconciliations that is also required to detect errors. Neither the journal vouchers, which contain the general ledger entries, or the trial balances, were signed and dated by managers, in order to indicate approval. We found instances of journal vouchers that omitted significant monthly entries, and entries performed twice, that would likely have been detected by supervisory review. Journal vouchers were not assigned sequential unique numbers. In an effort to correct errors, journal vouchers and trial balances were reperformed. We observed duplicate versions of journal vouchers and trial balances. Error corrections are more appropriately handled by issuing another journal voucher evidencing the amount of the correction needed.

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There were two sets of general ledgers maintained for the 1977 Police Officers and Firefighters' Fund. One set was maintained with totals given a calendar year set of records, and the other is fiscal year basis. These were not reconciled to each other. The calendar year basis is used by the actuary. The use of another set of records increases the risk of errors, which may be undetected. The use of another set of records for the 1977 Police Officers and Firefighters' Fund was not formally authorized. The practice was discontinued effective December 31, 2003.

We also recommended in our prior five audit reports, that procedures be documented in writing. This would help with consistency when there is a change in staff or staff responsibility. Procedures have not yet been documented in writing.

Indiana code 5-10.3-3-7 requires that "The board shall do all of the following . . . (5) Provide for the installation in the general office of a complete system of books, accounts including reserve accounts, and records in order to give effect to all the requirements of this article and to assure the proper operation of the fund."

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

#### BENEFIT EXPENSE

PERF did not detect a material error in the benefit expense recorded for the PERF fund. During the fiscal year, benefits expense was overstated for the PERF fund by \$38,150,818. The check register reports for benefits listed two subtotals for the PERF fund. The last line on the check register reports was incorrectly labeled as "Subtotal for PERF", when it was actually the grand total for the entire report, including all checks issued from all funds administered by PERF. This final "subtotal" was used as the total for the PERF fund benefit expense, and was also used in determining the checking account deposits each month. When we brought this to their attention, the benefit expense errors were corrected.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures.

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TAX WITHHOLDING REMITTANCE ERRORS

PERF does not maintain withholdings control accounts. A control account would include entries to compile total taxes owed and would reflect payments issued.

During fiscal 2003, errors occurred in remitting tax withholdings in an accurate and timely manner. Tax withholdings were not remitted in August 2002 and thereafter were remitted one month late until November 2002. For the period August through December 2002, tax withholdings for manual checks issued were not remitted. For the period January to June 2003, PERF could not provide detail calculations or support for the withholdings remitted. PERF also could not locate or provide a comparison of the 2002 taxes remitted to the total as reported on the 1099 reports issued.

The Internal Revenue Service assessed penalties for 2002 and 2003 for four funds that PERF administers. A penalty of \$485.73 for the Judges' Retirement fund was paid.

At our request, for each fund administered, PERF itemized and identified the federal and state taxes withheld from each system check register and manual check issued for the period July 1, 2002, to June 30, 2003. PERF compared this to the withholdings remitted. Variances existed for both federal and state withholdings for six of the seven pension funds administered. The net effect was that two funds had net total underpayments and four funds had net total overpayments. The net differences ranges from \$54,840 underpaid for the 1977 Police and Firefighters' fund to \$2,291,147 overpaid for the PERF fund.

Every governmental unit is required to comply with all filing requirements of federal and state agencies.

Officials and employees have the duty to pay claims, remit taxes, etc., in a timely fashion. Any penalties, interest or other charges paid by the governmental unit may be the obligation of the responsible official or employee.

ACCOUNTING FOR VOIDED CHECKS

PERF has not had procedures in place to account for void check transactions since at least July 1, 2001.

The computer system used by PERF provides for check status changes to be recorded, one of which is to void the check. We found that except for the 1977 fund, there were no accounting entries made to account for voided checks for the past two fiscal years. The entry would be to reduce expenses and correspondingly reduce deposits into the checking account. The general ledger accountants were unaware of the existence of SIRIS reports that identify the voided checks. There also were no procedures in place to review and approve the void check transactions, or to account for the withholding taxes associated to these voided checks.

The checks voided during the fiscal years ended June 30, 2002 and 2003, totaled \$ 1,546,784 for four funds.

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Each agency is responsible for maintaining an effective and accurate accounting system for subsidiary and supplementary records. At all times, the agency's manual and computerized records, subsidiary ledgers, control ledger, and reconciled bank or Auditor's balance should agree. If reconciled bank or Auditor's balance is less than the subsidiary or control ledgers, then the responsible official or employee may be held personally responsible for the amount needed to balance.

CHECK ISSUANCE PROCEDURES

PERF uses an outside service to print the checks it issues. PERF did not have procedures in place to ensure that the check run information was properly received and processed by the printer. On at least three occasions, check runs were not printed when they were originally ordered and PERF did not detect the errors in a timely manner. PERF also did not compare information printed, such as quantities and dollar values, to that which was ordered. PERF also did not account for the sequential series of checks issued.

Prior to sending the check print file to the printer, at least two accounting staff and other computer contract staff have access to update the file. This could result in unauthorized changes to the checks printed, that would not otherwise be reflected in PERF's records. PERF staff should not have access to the check print file. Update access to the check print file should be restricted to the SIRIS process user ID that creates the file.

Check register files were not all retained by the accounting department for audit. We identified those missing and they were provided from the system archives. In order to examine evidence of final registers as determined and used by the accounting department, the computer files should be retained by the accounting department in an organized, available structure for audit. In addition, PERF should be able to identify which check run data is final, and reconcile it to the amount printed. Two versions of the same final check register for September 2002 payments were observed, one of which had another check reported as issued. Other final check registers were found to have inaccuracies in the check numbers issued.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of managements' objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets, and forms of information processing are part of an internal control system.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making.

LACK OF CONTROLS - MANUAL CHECKS

Manual checks are those checks printed or typed independently from the computer system. PERF must use manual checks to issue replacement checks as the system does not have this function. Also, manual checks have to be issued to pay some benefits for system transactions that have failed. The system is limited to printing benefit checks once a month. A policy was put in place to issue manual checks for all first benefits, or refunds that were not processed within one month, or that indicated an immediate need. The number

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of manual checks issued in fiscal 2003 was an increase of 300% over the total issued in fiscal 2001, and 84% more than was issued during fiscal 2002. Check amounts also increased and were observed as issued up to \$125,000, as a first month benefit payment regularly includes the entire balance of the savings account.

The manual check recording process consists of procedures with multiple points of repetitive entry without review to ensure accuracy, propriety, or subsequent system entry. Manual checks were largely printed using a software package. A detail spreadsheet is maintained which indicates whether checks are replacements or original, however it only lists the net check amount. Photocopies of the check stubs for manual checks issued are made and transmitted to the accountant in order to effect general ledger recognition and checking account deposits. The check stubs do not identify the issuing fund, or whether the payment was for a benefit or refund. Our analysis indicates that approximately \$1.1 million issued for refund checks was misclassified as benefits expense. Misclassification of these expenses affect the reserve to which it belongs, either members reserve or the benefits in force reserve. In this case, the benefits in force reserve were incorrectly charged.

We identified benefits expense overstatements totaling \$2,041,586. These were caused by submitting duplicate and triplicate photocopies of manual check stubs for the accountant to add and recognize as original issue checks. Also, it includes an error of recognizing a SIRIS check register that was not actually printed, and also recognizing the expense for the replacement checks issued. Other math errors were also found in the calculator tapes that evidence the compilations of the original issue manual checks. Perf corrected the errors when it was brought to their attention.

We also found instances where: the input into SIRIS did not agree to the software records that printed the checks; records could not be located to support the checks issued; and checks that were recorded as voided were cashed.

Other internal control weaknesses related to manual checks include:

- (1) Insufficient segregation of duties as the same person is involved with issuing, recording and mailing checks.
- (2) Insufficient segregation of duties as those who order the manual checks to be issued retain any supporting documents without review by the disbursement accountant.
- (3) No process for verifying that replacement checks are properly classified in the manual check register. Manual check requests are not filed in numerical order in a single location.
- (4) Checks submitted for the general ledger entries were not compared to the spreadsheet or to subsequent SIRIS entries.
- (5) There was no record maintained to indicate which manual checks had been posted to SIRIS.
- (6) SIRIS records the manual checks as issued when entered onto the system, not when they were actually issued on a prior date. This could affect tax reporting years.

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- (7) The bank reconciliation process only accounts for those manual checks entered onto SIRIS. There is no outstanding check list maintained for manual checks not yet entered into SIRIS. As of August 2003, over \$2 million dollars of manual checks issued during fiscal 2003 had not been entered into SIRIS.
- (8) There was insufficient security during fiscal 2003 regarding the unused check stock.
- (9) Tax withholdings for original issue checks were not remitted or accounted for in a timely manner.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

INTERNAL CONTROL OVER CONTRIBUTION REVENUE COLLECTIONS

Our testing of contribution revenue collections revealed the following deficiencies in the internal control structure:

- (1) Duties were not sufficiently segregated in the processing of manual contribution payments. The same employee prepared the deposit, posted SIRIS, and posted the cash receipts ledger.
- (2) Collections received without proper accompanying paperwork were not adequately safeguarded prior to being deposited.
- (3) Temporary member accounts are set up for contributions received without accompanying member records. These accounts are changed to permanent when proper member record information is received. There is no check performed to determine the status of temporary member accounts on the system to detect errors or misuse of those accounts. A contract was in place for a vendor to research and resolve temporary accounts; however, it was cancelled in March 2003, due to the vendor wanting to shift the work out of state.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

1977 POLICE & FIRE FUND CONTRIBUTIONS

The 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) receives employer and employee contributions at the rate of 21% and 6%, respectively, of the salary of a first class officer or firefighter. PERF does not ensure that employer and employee contributions are recorded in the correct

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proportion to each other in the financial statement accounts or identify reasons for differences. This is a lack of internal control over the recording of employer and employee contributions in financial statement accounts.

In our review of 1977 Fund contributions, we determined that total employee contributions recorded on the general ledger were significantly more than the correct proportion of total contributions. For fiscal year 2003, total employee contributions recorded for the 1977 Fund are estimated to be \$2,029,000 more than they proportionately should be. This indicates errors were made in classifying receipts as to the fund, or between employer and employee contributions.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

#### LACK OF BENEFIT TRANSACTION ACCOUNTING

There was no definitive population data for new benefits; benefit adjustments; or benefit deletion transactions. The expected benefit payroll is not tracked or monitored by either number of expected checks to issue or dollar amount authorized. These were designed to be provided in a Monthly Payroll Summary Report with further itemized detail provided in monthly reports entitled: New Retiree Detail, Monthly Benefit Adjustment Detail, Reinstated Retiree Detail, and Retirees Suspended/ Terminated Detail. The reports are not functioning as designed. The transaction detail provided did not support the change in the monthly benefit payroll issued. Also, we found new retirements that were not reported.

Transaction information should be provided to managers for monitoring purposes. For the PERF fund, pension administrators identify new retirements from a spreadsheet prepared internally to track files processed. There is no such listing prepared for the other funds administered by PERF.

The computerized accounting system must maintain electronic audit trails sufficient to trace all transactions from original source of entry into the system, through all system processing, and to the results produced by the system. The audit trails must also maintain sufficient information to trace all transactions from the final results produced by the system, through all system processing, and to the original source of entry into the system. These audit trails must be protected from modification and deletion.

The computerized accounting system must incorporate features that assure all accounting information is reported accurately and completely. Output reports must have appropriate subtotals to allow reconciliation of reports within the system and reconciliation to external documentation.

#### BENEFIT AND REFUND SYSTEM CONTROL WEAKNESSES

The processing of benefits and refunds occurs thru the computer system, which maintains the subsidiary accounts for the members and employers reserves. Control weaknesses over the processing of benefits and refund transactions in SIRIS included the following design weakness conditions:

PERF had certain system controls disabled such that disbursements against a member's annuity account may exceed the balance in the account. Additional monitoring was not implemented.

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The segregation of duties that PERF may accomplish is limited by incompatible functions that exist within system defined roles that allows users to approve their own work. There also is no inquiry only capability, such that access to process transactions are given to those whose duties are to only observe transactions.

The system design was insufficient in order to ensure benefits and refunds were calculated and paid accurately in an efficient, timely manner with respect to the processing of the final contributions. Also see FINAL ANNUITY SAVINGS ACCOUNT CONTRIBUTIONS NOT PAID.

SIRIS design omits a transaction to record final service credit. Service credit is regularly recorded in quarter year increments upon posting quarterly contributions. Upon retirement, the exact service credit must be calculated and compared to the system total. In order to post the exact service credit total, PERF staff must now access and delete contribution entries and re-enter them with the same contributions with the service credit changed. This design has required an additional level of review for this specific transaction to ensure the contributions are re-entered correctly. However, we observed that contributions were re-entered as received in prior periods.

SIRIS operation weaknesses that pertain to the processing of benefits and refunds included the following:

- (1) Inadequate segregation of duties. Staff were generally assigned too much access. Combined role assignments give many users the ability to audit their own work or to perform incompatible functions within SIRIS.
- (2) SIRIS maintains check records for disbursement transactions that have been entered, but not yet authorized. As of September 26, 2003, a total of over \$7 million remained in the entered status for 230 checks dated from April 2002 thru June 2003. There were no procedures in place to research and resolve these transactions. Those which we observed should be deleted, as their issuance would result in a duplicate payment.
- (3) Lack of monitoring of completed transactions to ensure both system and manual procedures were accurate and correctly applied.

The computerized accounting system must provide input edits and controls to assure that information entered into the system is accurate, that all appropriate information is entered into the system, that information is entered into the system only once, and that all information entered into the system is authorized by management.

Written procedures must be available for all computerized accounting systems which provide instructions on the requirements for the approval of information prior to entry into the computer, as well as the accurate entry, processing, and reporting of information from the accounting system.

#### UNDERPAYMENT OF STATE EMPLOYEE DISABILITY PENSIONS

State employees who become disabled may begin to receive their PERF disability retirement while also receiving the state long term disability benefit. Additional state service is earned while on the long term disability plan. The state disability plan administrator reports to PERF when the state disability benefit term is completed, which cannot exceed a four year term. The PERF pension benefit should then be increased by recognizing the total state service credit.



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Since May 2002, PERF has not recomputed any state employee disability retiree pensions after the completion of their coverage under the long term disability plan, unless the member contacted PERF to complain. A state employee disability retiree that had completed their long term disability plan was found in our testing to be underpaid by \$2,552.52 annually.

Indiana code 5-10.2-3-1(f) states: "A member who is a state employee is entitled to service credit for the time the member is receiving disability benefits under a disability plan established under IC 5-10-8-7."

FINAL ANNUITY SAVINGS ACCOUNT CONTRIBUTIONS NOT PAID

Member contributions are remitted on a quarterly basis by their employers as required by IC 5-10.3-7-12.5. Members regularly retire or request refunds prior to PERF's receipt of their final contributions. If final contributions to members' accounts are received and posted subsequent to the retirement or refund transaction entry on PERF's computer system, the contributions will remain in the employee member's account. This also occurred for account refunds processed for the non-PERF funds.

Twenty percent (22 of 108) of member retirements and refunds that we tested for the fiscal year ended June 30, 2003, did not receive their final contributions that were posted to their account. The total unpaid to those members was \$8,084.71.

We also found three instances of PERF retirees', whose final contributions from 2002 were not recorded to their accounts, and as such they did not receive them and there would not be a computer record for subsequent payment to occur. The total unpaid to those members was \$759.58.

Indiana code 5-10.2-2-1.5 requires that:

- "1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law.
- 2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

PERF Fund retirees are entitled to the entire amount credited to the member in their Annuity Savings Account under various payment options in accordance with IC 5-10.2-4-2. "After a member suspends his membership, he is entitled to withdraw in a lump sum the amount of his contributions plus interest credited to him." (IC 5-10.2-3-6)

Indiana code 5-10.3-3-7 states, in part: "the Board of Trustees shall . . . 5) Provide for the installation in the general office of a complete system of books, accounts including reserve accounts, and records in order to give effect to all the requirements of this article and to assure the proper operation of the fund."

FINAL QUARTER INTEREST NOT PAID

PERF posts interest to member accounts at the end of each calendar quarter. A PERF Fund member's final quarter interest earned on their annuity savings account is to be included in the amount annuitized, refunded, or paid to the retiree.

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Due to the timing of retirement transactions, we found that certain retirements processed were omitted from the quarterly interest posting. In our review of the PERF Fund, we found that when the retirement is authorized by PERF at the end of a quarter, but paid the first month of the next quarter, the last quarters' interest was not posted to their account, and therefore, is not included in the amount paid to the member.

In our testing of PERF retirees that rolled their Annuity Savings Accounts to a qualified plan, we found three of twenty-seven that did not receive all the interest earned in their account for the last quarter before their effective retirement date. Total interest owed to these three retirees is calculated at \$1,889.37.

" . . . When a member who participates in the guaranteed program retires, becomes disabled, dies, or suspends membership and withdraws from the fund, the amount credited to the member shall be computed without regard to market value and is based on the balance of the member's account in the guaranteed program as of the last day of the quarter preceding the member's distribution or annuitization at retirement, disability, death, or suspension and withdrawal, plus any contributions received since that date plus interest since that date." (IC 5-10.2-2-3 (g)).

" . . . When a member who participates in an alternative investment program retires, becomes disabled, dies, or suspends membership and withdraws from the fund, the amount credited to the member shall be the market value of the member's investment as of the last day of the quarter preceding the member's distribution or annuitization at retirement, disability, death, or suspension and withdrawal, plus contributions received after that date." (IC 5-10.2-2-3 (f)).

#### INCORRECT PERF BENEFITS

Nineteen percent (10 of 53) of the PERF Fund new retirees tested were paid an incorrect monthly benefit. The errors in benefit calculations resulted in five retirees being underpaid a total of \$988.44 annually, and five being overpaid a total of \$345.48 annually. These errors appeared to be due to errors in manual calculations or data entry.

PERF Fund retirees are entitled to the properly calculated monthly pension benefit under the various payment options in accordance with IC 5-10.2-4-4, IC 5-10.2-4-5, and IC 5-10.2-4-7. PERF Fund retirees are also entitled to the properly calculated monthly annuity benefit under the various payment options in accordance with IC 5-10.2-4-2.

#### RETROACTIVE PERF DISABILITY BENEFITS

PERF Fund member disability pensions are calculated back to the effective disability onset date. If there were cost of living adjustment (COLA) pension increases during the period from the effective disability date to the date that the pension is determined, these increases are included in the current pension benefit base amount.

In our review of PERF Fund new retirees and disability retirees, it was determined that disability pensions were calculated without including COLA pension increases that occurred between the effective disability date to the date that the pension benefit amount was determined.

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In our testing of PERF Fund new retirees, we found six of the fourteen disability retirees items tested did not include retroactive COLA pension increases from the effective disability date when calculating the current monthly pension benefit base amount. The six were underpaid a total of \$747 annually, with the total omitted COLAs ranging from 1.4% to 12%.

In addition to not having the COLA increase included in the pension calculation, three of the six disability retirees also had the initial retroactive benefit calculated incorrectly. Two were underpaid by also omitting the COLA from the retroactive benefit. One was overpaid four months' pension benefits between their effective disability onset date and when the five years of service requirement was attained.

PERF Fund retirees are entitled to the properly calculated monthly pension benefit under the various payment options in accordance with IC 5-10.2-4-4, IC 5-10.2-4-5, and IC 5-10.2-4-7.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

#### INCORRECT DEATH IN SERVICE REFUNDS

Member account refund amounts are calculated and determined by PERF's computer system, based on the data and parameters established in the system. Refunds of member accounts to death in service beneficiaries were not being processed correctly by PERF's computer system. Refund transactions recorded on member accounts did not match the check amounts paid. These were found to have occurred for both the PERF fund and the 1977 Police Officers' and Firefighters' Pension fund.

In our testing of refunds of member accounts, we found five of five death in service refunds were paid an incorrect amount. Three of these had final contribution and/or interest amounts that were coded on PERF's computer system as removed from the member's account, but were not actually paid to the member's beneficiary. The fourth item had two beneficiaries, one of whom was paid half the remaining account balance, and the other was paid the entire account balance. The fifth item had the final contributions refunded twice but omitted the final interest.

PERF Fund members are entitled to the entire amount credited to their Annuity Savings Account in accordance with IC 5-10.2-4-2, IC 5-10.2-3-6, and IC 5-10.2-3-7.5(e).

1977 Police and Fire Fund members are entitled to the entire amount credited to their member account in accordance with IC 36-8-8-8, IC 36-8-8-16, and 35 IAC 2-2-1.

Each agency, department, institution or office should have internal controls in effect, which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system.

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UNPAID RETROACTIVE BENEFIT

For new retirees, a retroactive payment is made for all benefits owed from the effective retirement date to the payment date. This retroactive payment is to include all prior monthly benefits, plus the additional thirteenth check pension benefit amounts since the effective retirement date. This would primarily occur for disability benefits. The thirteenth check represents additional benefits paid, as authorized by the legislature, which do not increase the base pension.

We found that the computer coding to increase benefit checks for the retroactive thirteenth check pension benefit, also correspondingly deducts it from the check. Therefore, the increase was not paid to those receiving the retroactive adjustment.

Indiana Code 5-10.2-2-1.5 states, in part:

- "(1) Each board shall distribute the corpus and income of the fund to members and their beneficiaries in accordance with the retirement fund law.
- (2) No part of the corpus or income of a fund may be used for or diverted to any purpose other than the exclusive benefit of the members and their beneficiaries."

EMPLOYERS RESERVE CHARGES

Employers reserve charges are the actuarial costs to the employer for the funding of the member's pension at retirement. In our testing of employers reserve charge amounts we found the following errors:

- (1) The 1977 Police Officers' and Firefighters' Fund incorrectly uses the PERF Fund Employers Reserve Charge table instead of the 1977 Fund Employers Reserve Charge table established by PERF's actuary. This varies significantly from the table used for the PERF Fund.
- (2) The actuarial cost tables have not been updated to that currently approved by PERF's actuary which incorporates different interest rate and mortality assumptions. This occurred for the Judges', Legislators', and Prosecuting Attorneys' Retirement Funds.
- (3) In our testing of PERF retirements, four of fifty three tested had an incorrect employer reserve charge calculated. Two employers were overcharged a total of \$ 81,597. The other two employers were undercharged a total of \$1,982.
- (4) The actuarial tables have retiree only, joint (spouse), and survivor factor columns for calculating the cost of benefits. These factors were found to be incorrectly applied for the benefit cost of all Prosecuting Attorneys' and Legislator Fund new retirees tested, and for nine of ten Judges' Fund retirees tested. The retiree only factors were applied to those who were married, and alternatively the joint factor was applied for those who were unmarried. Although the joint table was applied for four married Judges', the incorrect age factor was used.

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- (5) Employer reserve charges were incorrect for all three 1977 Fund death in service benefits tested. In one case the benefits were underfunded by 27%, or \$59,000. The other two cases were overfunded by 32%, or \$49,000 and 78%, or \$307,000, respectively.

The actuary tables that were adopted by the Board of Trustees in accordance with IC 5-10.3-3-7(7) should be those in use. The factors should also then be accurately applied.

PUBLIC EMPLOYEES' RETIREMENT FUND  
BOARD OF TRUSTEES  
EXIT CONFERENCE

The contents of this report were discussed on April 14, 2004, with Mr. Craig Hartzler, Executive Director, and Mr. Garland Ferrell, Chairman of the Audit and Budget Committee of the Board of Trustees. The official response to the audit findings has been made a part of this report and may be found on Pages 21 through 36.



I N D I A N A

May 24, 2004

Charles Johnson, III, CPA  
State Examiner  
Indiana State Board of Accounts  
302 West Washington Street, Room E418  
Indianapolis, IN 46204

Dear Mr. Johnson:

This letter serves as our official response to the financial and compliance audit performed by the State Board of Accounts. Thank you for your diligent review and audit of PERF. We take this audit very seriously and will redouble our efforts to make PERF a world class \$10.5 billion financial services institution serving more than 260,000 members and 1,100 employers.

Of the 23 findings identified by your audit for the period ending June 30, 2003, PERF has, to date, resolved two findings completely and corrected significant portions of five more findings. We are working hard on the remaining findings and expect to correct all of the remaining findings, in order of importance to the operations of PERF, by the dates of June 30, 2004, September 30, 2004 and December 31, 2004.

My detailed response to your audit findings is attached. Let me take this opportunity, however, to place my response in the context of PERF's rapidly changing responsibilities and the growing complexity of serving our members, their families and our employers. In addition to the significant organizational challenges of growing from a single pension trust to a system of six separately managed retirement plans, the operational systems of the fund, including technology, remained fairly static until the mid-1990s. Since then, PERF has experienced significant system shifts to improve technology, increase accountability, and enhance customer service. Three events driving much of this challenging change are:

- The equity referendum of 1996 that lifted the constitutional prohibition of investing in the common stock of companies;
- The transition to new technical platforms driven by changes in both technology and customer expectations; and,
- After 55 years, the fund's transformation to a "separate body, corporate and politic" in 2000. This change occurred so that PERF could meet the challenges of carrying out the board's fiduciary duties of prudently investing fund assets and providing service to participating members and employers.

Prior to the late 1980s, the fund operated primarily on a manual calculation system that depended entirely upon paper. The paper-driven process was extremely cumbersome to process member and employer requests timely, and proved incredibly risky in terms of potential for loss of information in the transaction. In the late 1980s, we forged ahead to compute data using automated methods. This action was a step forward. It was not,

however, ideal for delivering more modern electronic services like web-based electronic wage and contribution reporting by our employers. Consequently, in the mid-1990s, the fund changed again to implement a Windows-based system, which utilized automated workflow, imaging, and office automation capabilities in order to provide higher quality service for members. In just one example of the changes that resulted, PERF converted millions of pieces of paper in its record keeping system into electronic images that can now be shared among staff in the different work processes of a transaction and improve the security of member and employer data. However, as I have addressed in the attached response, the technical transition dealt primarily with the improvement of the member and employer database and less with the underlying, and increasingly complex, accounting processes within PERF's operations. Now in the early part of the 21<sup>st</sup> Century, we continue to improve our technology platform by moving towards internet-based instant service and information delivery. These systems, when fully implemented, will provide our members and employers more access to real-time information about their accounts.

The dramatic improvements being pursued by PERF are not optional. PERF's membership is growing, as are the expectations placed on the fund by our active members, benefit recipients, participating employers, and the legislature. We are beginning to feel the effects of the "baby-boom" generation leaving the workforce and entering retirement. The recent early retirement programs offered by our larger employers and the increase in the federal retirement earnings limitation to keep older workers in the workforce are additional responsibilities we have accepted. The fund is also responding to the challenges of new state and federal laws being enacted in a fast-paced environment. New legislation, such as voluntary contributions, enhanced rollover payment options, additional service purchase allowances, and others have had an immediate impact on the fund's administration.

Over the past 15 months, we have aggressively moved to improve operations of PERF, particularly in the areas of internal financial controls, in the following ways:

- Eliminating the reliance on temporary workers;
- Requiring extensive background checks and fingerprinting all current and prospective employees;
- Securing another operational location for PERF operations in case of a disaster;
- Adding five professional staff to the finance/accounting area;
- Securing the services of a global cybersecurity firm to analyze PERF's operations;
- Further delineating the roles of staff within SIRIS to ensure the integrity of all transactions with members and employers; and,
- Enhancing oversight of all activity in the accounts of our members and employers by a significant reduction in the number of manual checks as a result of weekly check production and freezing inactive accounts.

Indiana Code 5-10.3-3-7.1 is referenced three times in the report. This statute states that the PERF board is to annually analyze the fund's income and expenditures, actuarial condition, reserve accounts, investments, and other such data for internal control purposes. To improve internal controls we are in the process of hiring a firm to review and analyze different operations and



procedures at PERF. The firm will make recommendations to improve our operations, processes, and related internal controls.

In short, the fund has been in a state of constant and considerable change for nearly a decade. We are working hard to stabilize our operational processes so we can better measure our technical and operational systems' performance in the short and long terms. As you know, many of the issues to which we are responding have been around for years. I am committed to expend the time and resources required to correct all the issues disclosed in this report, and firmly believe that we have already made significant progress in that direction. We view this audit report as another guide to improve our services for PERF members, their families and employers. On behalf of all of us at PERF, I want to thank the State Board of Accounts for this important road map to continuous improvement.

Sincerely,

A handwritten signature in black ink, appearing to read "Craig E. Hartzer", with a long, sweeping horizontal line extending to the right.

Craig E. Hartzer  
Executive Director

Cc: Board of Trustees

**A. INTERNAL CONTROL STRUCTURE AND ENVIRONMENT**

We recognize that this finding is general in nature and states that some problems have been ongoing for years. We have already taken steps and continue to make changes to improve internal controls and accountability at PERF. PERF has received responses to a RFP and plans to hire an accounting firm by July 1, 2004, to address these issues.

**B. CHECKING ACCOUNTS-CASH NECESSARY TO BALANCE**

We recognize that PERF has not adequately reconciled the benefit checking accounts for the past few years. To correct this problem we have hired a Reconciliation Accountant. Reconciling the pension benefit checking accounts will be one of the responsibilities of the position. This staff person will develop procedures to track transactions that may affect the account reconciliation. We have also started posting transactions for the benefit accounts in the general ledger. In the past this was not done, as the accounts in theory are zero balance accounts. This includes the transfer of funds from the investment accounts to the checking accounts, the gross expense, the net amount of the checks, the tax withholdings, the payment of taxes, and any other transaction that affects the benefit checking accounts.

We also plan to close the two current benefit checking accounts and open one new account. We have selected a vendor for banking services. We will start using the new account once opened and the Reconciliation Accountant will ensure it is reconciled monthly. We will cease to use the original benefit checking accounts. The Reconciliation Accountant will monitor the original benefit accounts until closed to ensure that only properly issued checks are cleared through those accounts. After a time period when all checks issued from the original accounts are out dated we will close the accounts. The new account will have fraud protection features including what is called Positive Pay.

Our goal is to start using the new account by September 30, 2004 and have the current accounts closed by December 31, 2004.

**C. RESERVE RECONCILEMENTS**

The reconciling of the reserves between the subsidiary accounts in SIRIS (member and employer balances) and the corresponding accounting general ledger accounts was made more complicated with the implementation of SIRIS.

One of the responsibilities of our new Reconciliation Accountant is to timely reconcile the reserves. This staff person will develop procedures to track transactions that may affect the reconciliation. One example is tracking the timing difference between money deposited and contributions being posted to members and employers accounts in SIRIS. We have also hired a firm to review the conversion from IRIS to SIRIS, the transactions on SIRIS, and the relating general ledger transactions. Our goal, with the help of this firm, is to have general ledger reserve amounts that correspond and reconcile with the amounts in SIRIS for the June 30, 2004 annual

financial report. They will help determine the adjustments to the general ledger and adjustments needed in SIRIS.

**D. INVESTMENT ACCOUNTING AND TRANSFERS**

Since the noted transitions occurred, we have put in place a system of checks and balances to ensure that the proper interfund transfers occur. Currently there are three different parties monitoring all investment transactions: PERF, the investment managers and the custodian.

The error that took place in the Annuity Savings Account (ASA) account in April 2003, and not corrected until August 2003, was caused by many different factors. We have since added new control procedures to ensure that all errors are caught within 24 hours of posting. The names of the two death benefit accounts have been corrected on the custodian's books.

Although the investment staff processes investment transfers, it takes two signatures with at least one from outside the Investment Division to transfer funds. Investment Division staff do not have the authority to set up other accounts. The Investment Committee of the Board monitors the overall investment portfolio. We consider this issue resolved as of May 24, 2004.

**E. MUTUAL FUND INVESTMENTS**

When the original transfers were made, it was determined that the board's approval was not necessary. In the future, we will ensure any transaction that requires board approval will be approved by the board prior to the transaction. During the March 19, 2004 Board of Trustees meeting, the three transfers that occurred from July through October 2002 and the two transfers that were made in June 2003 were ratified by the board members. We consider this issue resolved effective March 19, 2004.

**F. FINANCIAL ACCOUNTING AND REPORTING**

We have implemented a new computerized accounting system to handle the general ledgers, trial balance, financial reporting, budgets and budget reporting, and to track purchases and procurements. As we work with this new system and hire new staff, we will develop and improve our internal procedures to enter and post transactions. We have also hired a firm to develop and write procedure manuals for all PERF operations. They will review the several different aspects of our Finance Department including our procedures to enter and post the general ledger. We also have issued an RFP to hire a firm to review internal controls. This includes the controls relating to our accounting procedures.

We are entering and posting all transactions for the fiscal year July 1, 2003 - June 30, 2004, into the new system. As we do this, we will develop the best ways to accumulate, enter, and post the daily transactions. This will include what approvals are needed for each type of

transaction, separation of duties between entering and posting, and what management reports are needed. The new computerized accounting system allows management to review general ledger transactions on a continual basis and without staff printing reports.

Our plan is to have procedures substantially in place by September 30, 2004. We realize that the State Board of Accounts may have additional recommendations for improvement during their next audit.

#### G. BENEFIT EXPENSE

This problem was caused by how certain lines and sections in the check registers from SIRIS were identified. The accountant preparing the general ledger transactions for the issuance of benefit checks and the related investment transfers, which are based off the check registers, did not realize that the last total represented all funds even though it was labeled as PERF.

This problem was corrected as soon as it was brought to the accountant's attention in June 2003. Improving our reconciliation of the benefit checking account will help discover any similar situations. We are also looking at having a different report produced for each benefit check run that would be easier to read and abstract amounts needed to post to the general ledger, make investment transfers, and submit tax withholdings payments. We requested on April 16, 2004, through Problem Incident Report (PIR) 37261 that the check registers' grand total sections be relabeled. This PIR is scheduled to be put into production by June 30, 2004.

#### H. TAX WITHHOLDING REMITTANCE ERRORS

The benefit checking accounts, in theory, are to be zero based accounts. That is, we only deposit what is being paid out. Therefore, in the past, withholding control accounts were not considered necessary.

Based on questions by the Board of Accounts' Field Examiners and our own concerns, a major project of reconciling the taxes withheld and the amounts reported and paid was completed. From this project we found that the withholding taxes were overpaid .

As a result, amended tax withholding letters to the Internal Revenue Service (IRS) for 2002 for the seven retirement funds we administer were submitted. These letters were dated September 26, 2003 and covered the recalculation of taxes withheld July 1, 2002 through August 31, 2003. We also amended our 2002 reports to the Indiana Department Revenue (DOR) for July 1, 2002 through December 31, 2002.

Even before the completion of this project, staff responsible for the payment of withheld taxes were developing better ways to track the amount withheld and paid. Before the State Board of Accounts issued a finding, plans were developed to have withholding control accounts in the new accounting software system. We are currently posting the withholdings and the payment of withholdings to control accounts in the general ledger. The Supervisor of Budgets

and Planning developed procedures to ensure she tracked withholdings from the checks produced by SIRIS and manual checks.

Also, we now issue checks weekly. Therefore, we have started submitting the withheld taxes weekly, as well.

I. ACCOUNTING FOR VOID CHECKS

Before July 30, 2004, we will review the voided checks noted in the finding and make the appropriate adjustments. Finance Department staff will inform the Accounting Supervisor and the Supervisor of Budgets and Planning when a check is voided and not replaced. A thorough review of procedures will be done by December 31, 2004 and formal procedures will be established. The formal procedures will include who can change the check status in SIRIS, the communication protocol, posting voided check to general ledger, and accounting for any taxes withheld.

J. CHECK ISSUANCE PROCEDURES

Very seldom are the actual check files ever accessed or reviewed by PERF staff. Staff use the check register and other reports produced by SIRIS. However, we do agree the check files need to be secure. We are working with Covansys to make these files read only files since on occasion there is a need to check the file. However, staff will not be able to make any changes without the accounting manager's approval. Also, since July 2003, the vendor sends PERF reports of the number of checks and the total net amount of the checks that are on the file. We compare these reports to the check registers for accuracy and internal control purposes.

The system creates two check registers sorted by retirement fund. One is social security number order and the other is in check number order. Since March 2003, staff were instructed to print the check number order register.

We currently print out a check register for each benefit and refund check run. We will review the possibility of placing a copy of the electronic check register report in a secured location where all check registers can then be easily located by June 30, 2004.

K. LACK OF CONTROLS – MANUAL CHECKS

The implementation of SIRIS caused unexpected issues for certain types of PERF members and their retirement. This caused a significant increase in the number of manual checks. Management also increased the number of manual checks with the decision to issue the first retirement check as soon as practical and not wait until the next monthly run or wait until the retirement could be processed through SIRIS. Currently, there are approximately 150 manual checks each month for retirements that cannot be processed through SIRIS.

The manual checks for system failure is being addressed by several PIRs. These include PIRs 37611, 31950, 31706, 33084, 24680, 23688, 23934, and others that relate to specific issues that cause us to do manual checks. These PIRs are scheduled to be put into production by June 30, 2004. The ability to process replacement checks through the system is being addressed by PIR 663, which is scheduled to be put into production by June 30, 2004. The audit statement reading, "A policy was put in place to issue manual checks for all first benefits, or refunds that were not processed within one month, or indicated an immediate need" is incorrect. The corrected statement should read, "A policy was put in place to issue manual checks for all first benefits that were over one month old and refunds or benefits that indicated an immediate need."

In addition to the normal monthly payroll and refund run, we are executing weekly check runs. These weekly check runs pick up all pending refunds and both retroactive payroll benefits and retirement ASA withdrawals paid to the member. These weekly runs are sent to our vendor for printing, the same as any normal payroll or refund run. This procedure was put into place with the first weekly check run September 24, 2003, and has eliminated a significant majority of all refund manual checks, as well as manual checks for first benefits not processed within one month.

The spreadsheet maintained to track manual checks was updated beginning October 1, 2003, to list all the check detail. This update includes gross wages, taxes withheld, and net check amount.

Our response to the audit's comments on other internal control weaknesses related to manual checks is preferenced by the fact that all issues associated with segregation of duties will be evaluated by the vendor who performs the internal control review. Comments on specific internal control findings follows:

- 1) Manual benefit checks are signed by the Chief Financial Officer (CFO). The CFO has a list of those that are to receive their monthly benefit check through the manual process.
- 2) Manual checks, written due to a system failure, are requested with the file attached. Current procedure also has the benefit accounting section giving the CFO a spreadsheet listing all manual checks requested by our benefits department with amounts. The CFO checks the listing prior to signing checks and any discrepancies are researched immediately. The disbursement accountant does receive paperwork including lost check affidavit, estate affidavits, and the files for the monthly manual benefit checks.
- 3) The replacement check issue is being addressed with PIR 663, which is scheduled to be put into production by June 30, 2004. System Failure manual check copies are being kept with the files so that once the system is fixed and the member is authorized into SIRIS, all checks can be entered into SIRIS.
- 4) Most manual checks are manual because the retirement cannot be processed through SIRIS, and as noted above, there would not be a reason to compare the manual checks submitted for general ledger entries to SIRIS. Most of the remainder of the manual checks are replacements, and thus, would not need general ledger transactions. The spreadsheet includes all manual checks and not just what needs general ledger transactions. Currently, there is not an efficient way to compare the spreadsheet to the general ledger transactions. We evaluate using the spreadsheet to obtain the amounts for the general ledger transactions.

- 5) The disbursement accountant was instructed to include an indication that a manual check has been posted to SIRIS.
- 6) Although SIRIS initially records the manual checks on the date entered into SIRIS, we are currently changing the check date to the date the check was issued. This alleviates a problem with the 1099s.
- 7) We have hired a Reconciliation Accountant that has the responsibility to reconcile the bank accounts. Once the new benefit checking account is established and in use, the Reconciliation Accountant will include the manual checks, whether posted in SIRIS or not, in the reconciliation process. The target date to include manual checks is August 1, 2004.
- 8) In May 2003, the blank check stock was moved to a locked file cabinet to which only two people have keys.
- 9) Tracking and submitting withheld taxes are addressed under the Tax Withholding Remittance Errors section.

L. INTERNAL CONTROL OVER CONTRIBUTION REVENUE COLLECTIONS

We are in the process of hiring a firm to review several different processes. This includes the procedures and controls relating to receipt and posting of contributions. After the vendor has completed their review and analysis, they will make specific recommendations to improve our operating procedures and internal controls relating to contributions. PERF has a RFP out and plans to hire a CPA firm by July 1, 2004, to address these issues.

PERF still receives checks that can not, for various reasons, be deposited that day. (Checks not deposited are placed in the safe.)

The problem of temporary member accounts has long been an issue at PERF. Steps are being undertaken to allow employers to submit new employee information electronically. This will speed up the process, having members' accounts established before the quarter reporting, and thus, substantially reduce temporary accounts.

M. 1977 POLICE & FIRE FUND CONTRIBUTIONS

There is no evidence that the deposits were posted incorrectly in SIRIS, or that total contribution revenue in the financial statements is incorrect. It is possible the revenue objects used for the Report of Collections were reversed for a few deposits.

After we improve the reconciliation between SIRIS and the general ledger as noted earlier, an error in the use of revenue objects for the Report of Collections will become evident. The 1977 Police Officers' and Firefighters' Pension and Disability Fund is the only fund with a set percentage for employer and employee contributions. The fact that there can be the purchase of additional service included in the deposit means that the risk and the effect of such an error does not warrant specific procedures to check each deposit of the '77 Fund. We will review the ratio between employer and employee contributions as we prepare the year end financial statement. If the ratio is substantially off from the 21% employer contribution and 6% employee

contribution, a review will be done to determine the appropriate adjustment and the cause of the errors.

N. LACK OF BENEFIT ACCOUNTING

Along with the spreadsheet mentioned, SIRIS does produce management reports indicating what staff has worked on during any defined time period. The use of the reports mentioned, if they were accurate, would be used by staff in the Finance Department to help determine if there is some problem or error in SIRIS that is affecting the check process.

The audit uses the term "computerized accounting system." We do not consider SIRIS as an accounting system. SIRIS is a retirement database. However, a major portion of our account activity does come from the processes in SIRIS.

We are in the process of having other reports produced that will help in some of the monitoring processes. As already mentioned, we have also hired a Reconciliation Accountant. One of the duties of this position will be to review the reports mentioned in this finding, determine if they have been corrected, and develop procedures to monitor the change in the monthly benefit checks. Also noted earlier, we are in the process of hiring a firm to review several different processes and related controls. PERF plans to hire a CPA firm by July 1, 2004, to address these issues. After the vendor has completed their review and analysis, they will make specific recommendations to improve our operating procedures and internal controls. We expect this to include the monitoring of the monthly check runs.

O. BENEFIT AND REFUND SYSTEM CONTROL WEAKNESSES

On converted data, we do reverse and re-enter quarterly information to correct service. PIR 1461 was written to address the issue of reversing money as well as service. This PIR is scheduled to be put into production by June 30, 2004. The process used to correct service is Member Account Maintenance, which cannot be audited by the same person who validates the account.

If a termination date is entered prior to the contribution report being posted, then the correct amount of service is entered by SIRIS. In the retirement process, if there are additional contributions to post, they are posted as "anticipated" with the indicated term date. SIRIS does calculate that amount of service to add to the benefit calculation.

The 230 checks noted in the audit that are in the "entered status" would be duplicates if issued. The majority of these checks will be deleted as they are found during normal business. There should not be any new ones created because procedures have been put in place to delete duplicates created by SIRIS during the audit process for benefit payments. This process was put in place after the issue was brought to our attention in the Fall of 2003.



To correct the internal control weaknesses, we have issued a RFP to hire a firm to review our internal controls. This includes the roles and controls in SIRIS as well as manual processes. Based on their findings and recommendations, we will make specific changes to improve controls. The firm is expected to begin its work by July 1, 2004.

P. UNDERPAYMENT OF STATE EMPLOYEE DISABILITY PENSIONS

There are PIRs in effect to address the inability to recalculate these benefits correctly. All members that have been recalculated have been mostly by manual calculation and workarounds to SIRIS. The member mentioned will be fixed before June 30, 2004. Additional members will be fixed by December 31, 2004, as well as procedures addressed to keep these current.

We have issued a RFP to hire a firm to analyze and verify a substantial number of transactions since the implementation of SIRIS. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay them any amounts due. PERF plans to hire a CPA firm by July 1, 2004, to correct these issues.

Q. FINAL ANNUITY SAVINGS ACCOUNT CONTRIBUTIONS NOT PAID

A system change has been requested, PIR 10403, that will ensure the member receives any additional refund due and /or adjustment in the member's benefit amount when PERF receives the final contributions from the member's employer. This PIR is scheduled to be put in production by June 30, 2004. All members that have been affected by this issue will have their accounts fixed by September 30, 2004.

We have issued a RFP to hire a firm to analyze and verify a substantial number of transactions since the implementation of SIRIS. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay any amounts due. PERF plans to hire a CPA firm by July 1, 2004, to address these issues.

R. FINAL QUARTER INTEREST NOT PAID

PIR 24325 is in effect to address this issue. The 3 members listed in the audit will be reviewed and fixed by June 30, 2004. We will also request a listing of all retirees and disabilitants that were authorized in the last month of the quarter starting from June 30, 2002. We will then review these accounts and make the appropriate interest calculation.

We have issued a RFP to hire a firm to analyze and verify a substantial number of transactions since the implementation of SIRIS. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay any amounts due.

S. INCORRECT PERF BENEFITS

The ten members noted in the finding will be reviewed and their benefits appropriately fixed by September 20, 2004. We are also reviewing procedures with staff monthly and as needed.

T. RETROACTIVE PERF DISABILITY BENEFITS

The initial process has been reviewed and corrected. We abstracted from SIRIS all disability retirements authorized since Stage 2 of SIRIS went into production April 2002. We verify the benefits for each person. We plan to have this completed by December 31, 2004.

We are in the process of hiring a firm to analyze and verify a substantial number of transactions since the implementation of SIRIS. PERF plans to hire a CPA firm by July 1, 2004, to address these issues. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay any amounts due.

U. INCORRECT DEATH IN SERVICE REFUNDS

We are in the process of hiring a firm that will analyze and verify a substantial number of transactions since the implementation of SIRIS. This includes death in service refunds. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay any amounts due. PERF plans to hire a CPA firm by July 1, 2004, to address these issues.

V. UNPAID RETROACTIVE BENEFIT

PIRs 10777 and 11656 are in effect to address this issue. Depending on the PIR resolution, we will pay members any retroactive benefit due by December 31, 2004.

We have issued a RFP to hire a firm to analyze and verify a substantial number of transactions since the implementation of SIRIS. As they find transactions that need to be corrected we will make the appropriate adjustments to retirees' monthly benefits and pay any amounts due. PERF plans to hire a CPA firm by July 1, 2004, to address these issues.

W. EMPLOYER RESERVE CHARGES

We will hire an outside firm to look at retirement transactions and determine the employer charges. Based on their findings we will adjust employer balances in SIRIS. Edits to the SIRIS program will also be made, if needed, so the correct tables are used. We are also following up with our actuary to be sure we have the correct tables. We then will review and update the tables in SIRIS as needed. Our plan is to have this accomplished by August 31, 2004.

**E. WILLIAM BUTLER**  
4189 Riverbirch Run  
Zionsville, IN 46077

May 27, 2004

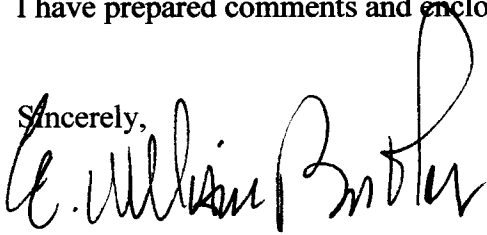
Mary E. Rankin, CPA  
Field Examiner  
State Board of Accounts  
302 West Washington St.  
Room E418  
Indianapolis, IN 46204-2765

Hand Delivery

Dear Ms. Rankin:

Thank you for sending me the draft audit opinion of the State Board of Accounts in connection with its audit of the Public Employees' Retirement Fund for Fiscal Year 2003. I have prepared comments and enclosed a copy.

Sincerely,

A handwritten signature in black ink, appearing to read "E. William Butler". The signature is fluid and cursive, with a large, prominent loop at the end of the last name.

E, William Butler

Enc.

**Comments to the draft Audit Opinion of the State Board of Accounts of the  
Fiscal Year 2003 Audit of the Public Employees' Retirement System**

I have been provided with a copy of the draft of the State Board of Accounts audit of the Public Employees' Retirement Fund for the 2003 Fiscal Year. My comments are drawn from my recollections and notes from the period during which I served as the Executive Director, as well as my knowledge of the Fund. During the period of my employment at the Fund, the staff worked diligently to resolve items appearing in the annual SBA audit. In the FY 2000 audit, 5 conditions were cited. For the FY 2001 audit, we reduced this number to 4 and by FY 2002 audit, there were only 3 items.

Because I resigned during the first quarter of FY 2003, I am unfamiliar with operations at the Fund for the larger part of that year. Accordingly, I am in no position to comment on the increase in the number of reportable conditions in the FY 2003 audit to 23.

- Internal Control Structure and Environment  
*Comment:* As a repeating item, senior staff took this issue very seriously. It was determined that hiring of an internal auditor would provide professional analysis of this problem and, in conjunction with the new IT system, allow the development of an effective set of internal controls.
- Financial Accounting and Reporting
- Reserve Reconcilements  
*Comment:* Both of these items are repeats. It was contemplated that the new IT system would allow the resolution of this issue. I understand the Fund has experienced some difficulties implementing the system, the accounting module of which was brought on line in mid-2002.
- Investment Accounting and Transfers  
*Comment:* It is my understanding that a compliance officer was finally hired in the investment department. Presumably, this person would be in a position to oversee the activity mentioned in the draft. In addition, it should be noted that during FY 2003, the Fund concluded a search for custodial services and should be in a better position to resolve this problem.
- Checking Accounts – Cash Necessary to Balance
- Mutual Fund Investments
- Benefit Expense
- Tax Withholding Remittance Errors
- Accounting for Voided Checks
- Check Issuance Procedures
- Lack of Controls-Manual Checks  
*Comments:* Not having seen these items in previous audits, I am unfamiliar with the issues.

- Internal Control over Contribution Revenue Collections

*Comment:* Historical problems with the integrity and accuracy of the information in the database, especially with regard to the build-up of temporary accounts, was one of the critical reasons for the decision to undertake a data scrubbing and clean-up project. It is my understanding that this project has been cancelled.

- 1977 Police and Fire Fund Contributions
- Lack of Benefit Transaction Accounting
- Benefit and Refund System Control Weaknesses
- Underpayment of State Employee Disability Pensions

*Comment:* I understand these issues to be related to problems with the implementation of the new IT system.

- Final Annuity Savings Account Contributions not Paid

*Comment:* See comment under "Internal Control over Contribution Revenue Collections," above.

- Final Quarter Interest not Paid
- Incorrect PERF Benefits Paid
- Retroactive PERF Disability Benefits
- Incorrect Death in Service Refunds
- Unpaid Retroactive Benefit

*Comment:* I understand these issues to be related to problems with the implementation of the new IT system.

- Employer Reserve Charges

*Comment:* The calculation of employer reserve charges requires actuarial analysis. With no actuarial expertise on staff, the Fund has always relied very heavily on its outside actuary for these calculations. Comments to this item should be read in conjunction with a review of the final report of the recent outside audit of the Fund's actuarial firm.

E. William Butler